United States Circuit Court of Appeals

For the Ninth Circuit

J. P. DUKE, as Supervisor of Banks of the State of Washington, and as Successor in Office of the Defendant CLAUDE P. HAY, as State Bank Commissioner of the State of Washington, FORBES P. HASKELL, JR., as special Deputy Supervisor of Banks of the State of Washington, and SCANDINAVIAN AMERICAN BANK OF TACOMA, a Corporation,

Appellants,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, FAR WEST CLAY CO. et al.,

Appellees.

No. 3953

Petition of Far West Clay Co. for a Re-Hearing.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

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The Bell Press, Printers; 719 Commerce St., Tacoma, Wash.

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PETITION FOR RE-HEARING.

The appellee Far West Clay Co. respectfully presents this petition for a re-hearing and requests the court to reconsider its decision with respect to the validity of the $70,000 mortgage in the hands of the Bank Supervisor and his right to foreclose it.

We earnestly insist that an injustice has been done to the lienors by this decision and that they have the right to enforce their lien against the property freed from the mortgage in question.

The bank sold the property to the building company by a deed with a convenant of warranty against encumbrances. The $70,000 mortgage was then a valid encumbrance on the property. The deed was recorded and thereupon the building company, representing that it was the owner of the property, induced appellees to furnish builders' materials to construct a building thereon. They relied partly on the title conferred by the deed.

The bank failed, and liens against the property having been filed by appellees and others, the Bank Supervisor, in charge of the liquidation of the bank, paid off this mortgage and now seeks to enforce it against the property conveyed by the bank, claiming that in his hands it is a valid and subsisting mortgage, prior to the liens that had attached after the conveyance of the property.

The opinion affirms the position of the Bank Supervisor and orders a foreclosure of the mortgage.

We respectfully submit that this opinion is erroneous. It was reached by a misunderstanding of our position and of the rules of law invoked by us. We took two positions with respect to this mortgage:

1. That the bank having assumed and agreed to pay it as part of the consideration for the property, if the Bank Supervisor was claiming a purchase money lien for the purchase price, which included the mortgage, he was in duty bound to pay the

mortgage. He not only claimed a lien for the amount of the purchase price, which included the amount of this mortgage, but he sought to enforce it in this action. Under such circumstances, when he purchased the mortgage it became satisfied, without regard to the question of his intent because it was his duty under such circumstances to pay and discharge it or, in any event—his paying it under such circumstances operated in law as a satisfaction of it. We still think that this position is sound and we urge a revision of the opinion on this question.

2. That the bank having conveyed the property by a warranty deed while it was encumbered by this mortgage, it could not thereafter have paid this mortgage and taken an assignment of it, nor could the Bank Supervisor do so; that a payment by either under such circumstances operated as a satisfaction and discharge of the mortgage; that a purchase of it inured to the benefit of the lienors whose liens had attached after the conveyance of the property.

The latter position is the one on which we most relied, because we thought, and still think, that this position is sustained by one of the best recognized and established rules of law. This position was outlined clearly enough in our brief at pages 13, 31, 32, 47, 53, 55, 59 and 72. On pages 46 and 47 of our brief are found the authorities sustaining the proposition. We quote the language of one of the well considered cases as follows:

"When one who has conveyed land with warranty, which is subject to a mortgage whether made by him or by another, afterwards takes an assignment of such mortgage, he holds for the benefit of the person to whom he has granted the land and the mortgage is in fact discharged by coming into his hands. Even if he should assign it to one who pays full consideration for it, the purchaser would acquire no lien upon the land. Jones on Mortgages, 867."

Brosseau vs. Lowy, 70 N. E. 901.

The rule is stated by Mr. Pomeroy as follows:

"If a person, who has conveyed land with a covenant warranting against encumbrances, afterwards pays off or takes an assignment of the mortgage against the premises, the same becomes extinguished. He cannot keep it alive as a subsisting lien, for to do so would be a direct violation of his covenant."

2 Pom. Eq. Jur. § 798.

The bank conveyed the property by warranty deed and the lienors, relying on it, furnished the builders' materials. For the bank or the Bank Supervisor to destroy the rights and equities of the lienors attaching under such circumstances, by an assertion of the mortgage against which it had covenanted, would be grossly unjust. The bank put the matter in that shape by its contract with the building company, and if the building company failed to pay for the land, this failure ought not

to give the bank or its Supervisor any rights superior to those of the lienors. The transaction may have been a foolish one on the part of the bank, but the lienors relied on the actions of the bank, and their equities, it seems to us, are superior to the equities of the bank. We think, however, that the question is not to be settled by a comparison or balancing of the equities of the respective parties, but rather by the fixed and immutable rule of law which prohibits the vendor from purchasing an encumbrance on the property in violation of his warranty against it.

This question, we believe, was not touched, considered or discussed by the court in its opinion. In this opinion the court said, "Briefly stated, the appellees contend that it was the duty of the bank to discharge and pay off this mortgage because of the warranty contained in its deed, and that when that duty was performed by the Bank Commissioner as the representative of the bank, the mortgage lien was extinguished and the mortgage satisfied."

The court then proceeds to point out that there was no legal duty on the part of the Bank Commissioner to discharge this mortgage and that in the absence of such a duty the payment by the Commissioner did not operate as a satisfaction of the mortgage.

The decision by Judge Shaw, referred to in the opinion of the court, is a correct statement of the law applicable to the question involved in that case,

but it has no real application to either of the two propositions on which we relied in this case. We did not contend that a legal duty to pay the mortgage aross by reason of the warranty, as the court suggests in its opinion. We did contend that this duty, as a matter of policy, existed by reason of the warranty—that it was the duty of the Supervisor to protect his estate from the damage arising from its breach; but this was not the legal duty referred to by Judge Shaw, nor was it the legal duty which the court in its opinion says we relied on in connection with the warranty.

The court confused our argument on this question with our argument on the proposition that a legal duty rested on the supervisor to pay the mortgage by reason of its being assumed by the bank and the further fact that at the time the supervisor purchased it he was claiming a lien for the purchase price which included the amount of the mortgage. This is the legal duty to discharge the mortgage, referred to in our brief, but it had no connection with the warranty. Perhaps the apparent necessity at times for us to discuss the two propositions together obscured our real position with respect to the effect of the warranty.

Our position with respect to the warranty was that if the mortgage had been paid by the bank it would have resulted in a satisfaction and it would have inured to the benefit of the building company and the lienor and that the situation of the Bank

Supervisor with respect to the subject was the same as that of the bank.

If the bank had paid the mortgage a satisfaction of it would have resulted without regard to the question of duty or intention. The same result followed the act of the Supervisor, but it was by virtue of the warranty and the rule we have stated with respect thereto. No question of duty or intention arose.

We contended and contend now that when the mortgage was paid by the Bank Supervisor it made no difference what his intention was; by reason of the warranty it became satisfied by virtue of the rule of law which is contained in the quotations from Jones on Mortgages and Pomeroy's Equity Jurisprudence, already set out in this petition. We are therefore justified in saying that the court has not passed on this question in the decision already rendered herein and we seek from the court a rehearing on it.

No blame can attach to the Bank Supervisor for purchasing the mortgage, because at the time, he held the $600,000 mortgage and it may have appeared necessary for its protection that the other mortgage should be assigned to him or disposed of in some way. No legal liability could attach to the Bank Supervisor, or his agents, for purchasing the mortgage under the circumstances, even if it is held by the court to have been satisfied and discharged by his act. This is settled by all the authorities.

"General obedience to the order and direction of the court is sufficient protection to the receiver, although the order may be erroneous or subsequently reversed, and he will not be personally liable for losses sustained in administering an estate pursuant to such orders and direction and in the exercise of good faith and ordinary care and prudence."

34 Cyc. p. 294.

It was suggested by the court in its opinion, "that the Bank Commissioner for some purposes may represent the bank, but in a larger sense is a public officer charged with the duty of collecting the assets of insolvent banks and liquidating their debts."

We do not understand just what bearing this proposition has on the question we are presenting. We desire, however, to challenge its correctness, if it is sought to apply it to the manner in which the Bank Supervisor deals with the assets of the bank. There are a number of cases touching this question, directly or indirectly, and in none of them is to be found a line or a sentence justifying this attitude of the court. On the contrary they all affirm the position that, except as to those matters connected with the administration of the insolvent estate which are controlled by express provisions of the statutes, the Bank Supervisor occupies the position and the relation, to all parties, of a receiver in equity.

The Supreme Court of this state recognizes this as the position of the Bank Supervisor and, in a case

which involved the measure of the rights of a bank supervisor under our statutes, they referred to them as being the rights of a receiver. The court, in speaking of the rights of the Bank Supervisor, said, "The general rule is that the receiver takes the property of which he has been appointed in the same plight and condition and subject to the same equities and liens as he finds in the hands of the person or corporation or of whose possession it is taken", and we should regard this decision as a statement of the attitude of the Bank Supervisor under the law of this state and it should be binding on this court.

Moore vs. American Sav. Bank & Tr. Co.,
111 Wash. 148.

We desire to refer the court to pages 53 and 55 of the brief filed by us in this case for a presentation of this question.

The Bank Supervisor, under the laws of this state, is charged with the performance of certain duties, of a public character, with reference to the control and supervision of banks. These, in a sense, are governmental functions. The legislature, however, saw fit to extend his duties. Perhaps it was wise to have him wind up the business of insolvent banks instead of leaving it to a receiver appointed by some court. This duty, however, can hardly be called a governmental function. The general public has no interest in it. It is a matter affecting only those whose private interests are involved.

Suppose, however, that the assumption by the court in its opinion is correct and that a bank supervisor, in a broad sense, is a public officer.

Does it follow that in the administration of the affairs of the bank he is not controlled by the rules of law regulating the rights and duties of the respective parties, as defined by the express law of the land? In the absence of any provision in the law which creates him, limiting or defining his duties or powers, are they not to be determined by reference to the general law on the subject?

That certain duties, usually performed by a receiver, are, for convenience or policy, vested in one who also performs governmental functions, to the subject of which these duties are more or less related, surely does not bring the discharge of them within the definition of governmental functions, so that the policy or sovereignty of the state supplants or controls the private rights of the parties. A decision which removes the administration of the assets of an insolvent bank from the general laws regulating the rights of the parties and their private affairs, and transfers it to the realm of public policy and government control, with a consequent modification of these rights, is clearly not justified unless the express provisions of the law require it. Our statutes contain no such ideas or provisions. Such a decision under the existing circumstances will create confusion and will do harm. It is dangerous, if not revolutionary, in its tendency to in-

ject the government into the private affairs of the people. We have too much of that already.

The assets of an insolvent bank in this state, under the banking laws, are to be administered in accordance with the private rights of the parties interested, and these rights are defined by private law and not by the canons or rules of public policy.

In the case of *People's State Bank of Lakota vs. Francis et al.*, 79 N. W. 853, it is said,

"The fact is the receiver of a national bank is neither an indorsee nor an assignee for value. He is simply an agent and officer of the United States. *Ex parte Chetwood*, 165 U. S. 456, 17 Sup. Ct. 385, and cases cited. The government places him in charge of one of its financial agencies for the purpose of closing it up and terminating such agency, and in so doing he simply acts in lieu of the officers of the bank. He replaces them, stands in exactly their shoes, so far as the assets are concerned, and their knowledge necessarily becomes his knowledge."

In *Ward vs. Oklahoma State Bank of Atoka*, 151 Pac. 852, it is said:

"In this situation of the law, it seems to us that the position of the bank commissioner in taking charge and collecting the assets of a failed bank is quite analogous to that of a receiver or trustee in bankruptcy, or of an assignee for the benefit of creditors."

In the case of *Scott vs. Armstrong*, 146 U. S. 499, 36 L. Ed., it is said:

"The receiver took the assets of the Fidelity Bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of a statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached."

We call the attention of the court to the cases referred to on pages 82 to 86 of our brief in this case. In no case which we have examined is to be found a suggestion that in the administration of the assets of an insolvent bank the Bank Supervisor can apply or employ any higher law than that which regulates the private rights of the parties.

We must conclude that the status of the Bank Supervisor is the same as that of a receiver, and we refer the court to the cases and argument on pages 65 *et seq.* of our brief in the case.

In its opinion, on page 9, the court does not speak tolerantly of the claims of the lienors to a preference over the mortgage and seems to attach much importance to the supposed superior equities of the depositors. The equities of the depositors, if they are to be considered in this case, are inferior to the equities of those who dealt with the property by reason of the contracts of the bank. The depositors give their money to the bank to be used in its business. It is their act that enables the bank to wrong

others by breaches of its contracts. There is a rule that he who puts it in the power of another to act should not complain. The analogies of the law recognize no superior equities in the depositors. In some states they are specially protected, but not in Washington. We doubt the fairness of the law giving them special protection. It was the acts of the bank, in a sense the agent of the depositors, that induced the lienors to furnish their materials. The warranty of the title and the express promise of the bank to pay the mortgage, and the representations of the bank, all united to produce the result, and yet for a legal conception of the rights of the parties is substituted a sentimental consideration—the supposed equities of the depositors! It is suggested that the Bank Supervisor would have had no right to pay off the mortgage under the order of the court. I ask, why not? It was bought, as shown by the petition and order, to protect the $600,000 mortgage. If it had been satisfied the protection would have been just the same, but for the misfortune, not then anticipated, that overtook the latter mortgage.

In its opinion, the court suggests that the lienors are too grasping when they claim the benefit of the money actually invested in the building and then deny the right of the Supervisor to hold the $70,000 mortgage as a prior lien. It is suggested by the court, in every vigorous language, that the equities

mortgage it became satisfied or inured to the benefits of the building company and the lienors.

Respectfully submitted,

R. S. HOLT,

Attorney for Far West Clay Co.

The undersigned attorney for Far West Clay Co. does hereby certify that he has read the foregoing Petition for Rehearing and that in his judgment the same is well founded and that it is not interposed for delay.

R. S. HOLT.